The state of higher education in 2012
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Introduction

The higher education sector is experiencing an escalating pace of change. Even colleges and universities with the greatest resources and strongest brands are confronting change, particularly as a result of the digital revolution that is radically impacting modes of learning and accessibility to knowledge. These changes are driven by market pressures — i.e., by the demands and expectations of students and faculty. At the same time, all of higher education continues its evolution in response to ongoing price pressures, to reduced governmental support, to growing competition from the for-profit higher education sector, to its own ethical challenges, and to changes in the regulatory environment. Boards, presidents, provosts and CFOs are addressing these risks and challenges with new strategies and unique action plans that are a far cry from traditional approaches to higher education.

The state of higher education in 2012 is the first in Grant Thornton LLP's annual series of white papers for colleges and universities. Our goal is to offer advice and guidance for trustees and management of higher education institutions as they respond to transformational change through strategic planning and enterprise risk management. We highlight key issues and external forces that are impacting the higher education community, and share trends and best practices. We hope you find this paper helpful as a planning tool. Comments to frank.kurre@us.gt.com are always appreciated.

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Education is becoming "anytime and anywhere"

Larry Ladd, Director, Higher Education Practice, Grant Thornton LLP

This past year demonstrated once again that higher education is becoming dissociated from geographical limitations. Those who think to themselves "MIT is in Cambridge" don't see the full picture: In addition to providing classes at its physical location, MIT now offers online access to courses, along with certificates documenting completion of those courses. The university will soon "host a virtual community of millions of learners around the world." But leaping over boundaries isn't limited to Web-based outreach. For example, Boston-based Northeastern University, like many other institutions of higher learning, has established a branch campus far from its nominal location. Northeastern is opening one campus in Charlotte, N.C., and plans to open more in Seattle, Wash., and elsewhere. Sebastian Thrun, formerly a tenured professor of computer science at Stanford, has quit his job to establish Udacity, which will offer low-cost online classes. Southern New Hampshire University, which is a small college if you look at its campus, has more than 7,000 online students and is expanding rapidly. It has already become "the second-largest online education provider in college-saturated New England," according to The Chronicle of Higher Education.

In going where the students are rather than expecting the students to come to them, these institutions are following the examples already set by for-profit entities such as the University of Phoenix and the Education Management Corporation. While many think only of the online component of for-profits such as these, they also have significant land-based presence. And because these for-profit institutions locate their classes where their students are, they move from locale to locale as the market changes. For that reason, they lease space rather than constructing buildings, freeing capital to be used for other purposes.

Intermediary entities are emerging to facilitate the sharing of knowledge and courses between faculty and students, sometimes through a formal institution and sometimes not. In one example, The Faculty Project, established by start-up Udemy, allows faculty at elite colleges and universities to provide their courses for free over an online platform. Through online learning, students attending even the smallest universities will have access to some of the best courses and faculty in the world. And even at the K-12 level, online and distance learning are establishing a beachhead.

Accreditors are scrambling, trying to figure out how to protect quality in the new online world. And the U.S. News & World Report is scrambling for ways to fit online programs into its ranking system.

Colleges and universities that stay landlocked and bound to only face-to-face classroom learning will quickly find that they are out of step with the expectations of their students and faculty — and that they are losing both students and faculty to the new world that is emerging.

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Technology will continue to transform your institution

Larry Ladd, Director, Higher Education Practice, Grant Thornton LLP

The technology revolution is occurring within colleges and universities more than in any other industry, led by students and faculty always looking for better ways to learn, to teach and to conduct research. Administrations are following their lead. Colleges and universities are integrating IT into their educational offerings, back-office administration and marketing methods. According to Inside Higher Ed’s Lev Gonick, “This past year’s experimentation by Stanford’s much-publicized global offering to tens of thousands of learners around the world followed by MIT’s MITx initiative™ demonstrated the seismic shift in how even our most storied institutions are embracing technological innovation to do more with less.

The increased pace of this innovation is in part a response to economic pressures. Tuition costs and student debt levels are climbing higher each year, while public investment in higher education is being scaled back. It may be only a matter of time before the aggregate weight of an old-school cost structure becomes unsustainable.

Change is called for, and technology could prove to be part of the solution by bringing down the cost of administering, marketing and delivering education to a broad spectrum of learners. Technological innovation is laying the foundation for broad curricula, numerous delivery methods and unlimited network access to knowledge sources unbound by geographical limitations. This same innovation represents the way to keep our higher education institutions relevant in today’s global community.

With the adoption of each new application or system solution, higher education’s dependence on IT grows as a way to reach distance learners, reduce costs and enhance the overall learning experience. As educators seek long-term solutions to today’s pressing problems, technology has the potential to be many things to many institutions.

As changes to IT are rolled out, even more possibilities for teaching and connecting with students — and keeping them safe — emerge. Technology is a laboratory for change in higher education. Whether an institution leads or follows the technological charge, the competitive, economic and social pressure to embrace digital innovation grows each year.

Online education

Online education, also known as distance education, uses the Internet to provide an interactive, dynamic learning space that may integrate conference call technology with browser-enabled applications. Students can interact with teachers and other students via the Web, watch video lectures of premier instructors, and gain access to digitized texts. Advocates of distance learning contend that online professors are able to spend less time preparing materials and more time teaching students how to interpret and use information.
Whether spurned as a low-quality learning alternative or praised for its potential to reach more learners, the prospect of online education tends to elicit strong emotions and widely differing viewpoints. The argument about whether Web-based tools do indeed facilitate high-quality education in a secure environment has by no means been settled. “By taking advantage of technology, we can deliver more individualized learning and in so doing improve learning and reduce costs,” says Robert W. Mendenhall in The Chronicle of Higher Education.12

The debate over quality, though, may be losing some of its heat, given the release of recent studies that affirm the high caliber of online offerings. A 2010 meta-analysis and review of distance education studies published by the U.S. Department of Education concluded that “online learning was as good as or slightly more effective than traditional face-to-face instruction.”13 And officials at institutions of higher learning are somewhat confident about the prospects for distance education: About 50 percent of college presidents responding to a recent Pew Research Center survey expect that in 10 years’ time, the majority of students will take at least one college course online, compared with 15 percent of students today.14

As online learning evolves, distance education is expanding the delivery options and learning strategies available to institutions and students. In Chicago, one school has abandoned instructor-led, classroom-based courses altogether, instead relying on screen time to deliver accredited materials and real-time teaching at a lower cost. The New York Times reports that lower cost and greater accessibility prompted the AFL-CIO to partner with the National Labor College and The Princeton Review to create a new accredited degree-granting online institution devoted to educating the federation’s 11.5 million members and their families.15 “With classes priced competitively to community colleges, the option is cheaper than most four-year colleges and for-profit schools,” Steven Greenhouse writes.16

The use of hybrid learning environments that blend classroom and online instruction is growing, as well. Under this model, students may come to campus for an intensive period of face-to-face instruction over a span of days, evenings or weekends, after which distance learning addresses the remainder of the coursework. This format usually reduces facility costs and minimizes disruption to students balancing the demands of school and work.

As online learning channels broaden in scope, quality and accessibility, leaders in higher education face challenges on a variety of fronts:

Loss of location advantage. Location becomes increasingly less relevant to students and faculty when learning is delivered online. Having only a single land-based campus will become a strategic and recruiting challenge. In the United States alone, there are more than 3,500 colleges and universities, all of which — until recently — have been held captive by their location. The location of a campus and the attributes of a college town become less important when courses are available anywhere, anytime.

Strong brands’ power grows. The proliferation of low-cost distance education alternatives threatens to undermine school branding. For the first time, students are gaining Web-based access to courses at some of the most prestigious schools in the United States, including MIT and Harvard. By offering free or discounted online courses that grant certification to students who are not otherwise enrolled there, institutions such as these extend their powerful brands into the market space of other colleges and universities.

On the other hand, these trends present opportunities for colleges and universities to expand well beyond their campus footprint into a global community of learners. In its current iteration, online education is an equal-opportunity phenomenon: All colleges and universities have a similar opportunity to take in learners far outside the geographical area from which they have traditionally drawn their student body. Smaller schools can act big by using technology to benefit from inbound marketing. For example, a student in Kenya who is interested in architecture is able to find and apply for instructor-led online courses at the Boston Architectural College.

Digital information

The advent of the digital age has altered the way we receive and disseminate information. Whether it is health records, student records or Google Docs, digital information is rapidly leveling the knowledge playing field among colleges and universities.

The days when a world-class library was a selling point for students and alumni are disappearing. Harvard’s once-sizeable competitive advantage from its libraries is being whittled away as its collections are digitized and made accessible to students,
faculty and the global community. Sixty-two percent of college presidents responding to the Pew Research Center study say that more than half of students’ textbooks will be digital in 10 years. The extent to which an institution’s collections have been digitized — and are therefore accessible online — and the breadth of the institution’s shared network matter far more than the texts sitting in the stacks.

Social media
Social media applications are also transforming the look and feel of higher education. Facebook, LinkedIn and Twitter are creating communities of learners where education and contemporary culture intersect. Students, alumni and faculty long used to Blackboard and other course management software for facilitating the give-and-take of information suddenly have new forums for small-group meetings and discussions, and additional channels for delivering learning materials.

Social media delivery models lower barriers to communication. Students too shy to speak out in class are more apt to offer up their viewpoints via Facebook, tweet a link to a topical article, or join one of LinkedIn’s many professional discussion groups to test real-world applications of classroom learning. The challenge for higher education is determining how to harness that opportunity to create communities, distribute materials, and provide leading-edge exchange platforms that matter to today’s learners and prospective students.

Mobile devices
Students are prepared to use smartphones and tablets to navigate institutional resources and use campus services. Colleges and universities are responding with mobile applications that put education on devices students prefer.

More technology providers than ever before offer mobile applications. Institutions of higher learning have made significant gains in deploying mobile apps over the past year alone. The Campus Computing Survey asked colleges and universities whether they were using mobile apps or planning to do so during the next academic year. The survey found that the number of public four-year colleges that expected to go mobile or had already done so had grown substantially, from 17.8 percent in fall 2010 to 43.6 percent in fall 2011. Of public universities surveyed, 55.3 percent deploy or plan to deploy mobile apps, versus 32.5 percent last year. The number of private institutions saying they offer or will soon offer mobile apps increased from 42.2 percent in 2010 to 50 percent in 2011, while the number of community colleges using mobile apps or planning to do so rose from 12.4 percent in 2010 to 40.9 percent in 2011.

This data bears out our belief that the affordable cost of going mobile will lead more colleges and universities to adopt applications that deliver instant messaging and on-the-go learning support.

Cloud computing
Cloud computing has not seen nearly the bump in use that mobile applications have. It is, however, expected to evolve rapidly over the next five to 10 years. Providers of cloud computing are already making inroads into the academic market, replacing servers and data storage at institutions of higher learning. Cloud computing puts shared resources, software and information on the Internet to be managed by commercial providers. Practically speaking, cloud computing allows colleges and universities to select enterprise activities to move off campus for faster, cheaper or safer accessibility.


\[17\] Ibid.

\[18\] Ibid.

\[19\] Ibid.
Moving to the cloud “makes less relevant where work happens and where data is stored.” While in theory institutions lose control of information they no longer house, many of them are drawn to cloud computing for the simplicity of offloading management responsibility — and its attendant headaches — for high-use operations such as data storage and email. According to the Campus Computing Survey, more than one-fifth of campuses (21 percent) have plans for cloud computing, up from 15 percent in 2010; use of the cloud is beginning with email and calendar functionality.\footnote{Hignite, Karie, Katz, Richard N.; and Yanoisky, Ronald. Shaping the Higher Education Cloud (EDUCAUSE/ANUBO white paper), May 2010.}

Campuses have been slow to move operational and research functions to the cloud. Just 4.4 percent of Campus Computing Survey participants report that their campus has moved or is moving to cloud computing for administrative system services.\footnote{The Campus Computing Project. The 2011 Campus Computing Survey, October 2011. Available at www.campuscomputing.net/survey.} Most confidential student, financial and HR information continues to be stored on in-house servers.

Key computing activities will be among the last to move to the cloud. As products and security improve, even mission-critical operations will migrate to lower-cost, higher-capacity computing in the cloud.

**Long-term technology policy**

Technology is on the leading edge of change at institutions of higher learning. Despite well-documented IT budget cuts at colleges and universities, leaders in higher education can harness this change by being in relevant technology that best meets economic, social or administrative challenges.

Both social media applications and mobile devices have a relatively strong presence on campuses today, thanks to low entry barriers, shared infrastructure and costs, minimal management overhead, and immediate access to information. For a generation of hyperconnected students, social media applications and mobile devices are expected forms of interaction. Admissions personnel who answer to this demographic have embraced these technologies in order to drive marketing efforts and broaden communication channels.

Already most institutions are established on Facebook, LinkedIn and dozens of other social media websites that provide always-on communication channels for streaming campus news and delivering educational content and course updates.

Faculty and staff aren’t far behind, adapting these same channels to disseminate information about academic, social, safety and wellness, transportation and administrative services.

Large-scale digitization efforts have been primarily market driven, as well. As text becomes digitized elsewhere, institutions are aggressively catching up, converting print into bytes and libraries into study halls. Educators are planning curricula and research projects around the extraordinary amount of digitized information that is now available. Students care about access to information, forcing the higher education sector to focus on making sure they have the right tools to gain this access. The smooth integration of online learning and cloud computing requires long-range planning. Leaders in higher education should take the opportunity to learn about these technologies now in order to anticipate change and stand out from the competition.

To approach distance education strategically, leaders should take a look at what competitors are doing and find ways to adapt learning environments according to the image and competitive advantages the institution wants to promote. An action plan may be as simple as assigning to an individual or a committee the responsibility for selecting technological applications, determining the appropriate implementation method, and tracking progress toward IT goals. Similarly, leaders should ease into the cloud with a plan in mind, particularly when it comes to addressing security concerns. This plan should satisfy the risk tolerance of trustees, while encouraging them to accept the cloud and keep the institution moving forward.

Institutions that view IT as a tool to further the mission of higher education — and institutions that have a plan in place for assessing and implementing relevant technologies — can create a purposeful learning environment for the next generation of learners.
Access and affordability

Larry Ladd, Director, Higher Education Practice, Grant Thornton LLP

Calls for making higher education more affordable continue to escalate, with President Barack Obama's most recent State of the Union address being a noteworthy example.

A college education is increasingly unaffordable for many students and their parents. The annual cost of a private college has grown from under 80 percent of per capita income to 112 percent since 1980, and the cost of a public college has risen from less than 40 percent to 49 percent.23 Average student debt per borrower at a private college was $22,300 in 1999 – 2000, as compared with $26,100 in 2008 – 09 (the most recent academic year for which statistics were available), according to the Federal Reserve.24

The federal government provides the bulk of undergraduate student aid through loans (43 percent), Pell grants (18 percent), grant programs other than Pell (8 percent), education and tax credits (4 percent) and work-study (1 percent). Of all undergraduate student aid, 6 percent comprises state grants.25 These aid programs are prime targets in government deficit reduction strategies and are unlikely to survive at their present levels, putting more pressure on affordability.

Although calls for government regulation of educational costs (or, alternatively, for incentives to reduce those costs, as President Obama has proposed) have intensified over the past decade, we believe that self-regulation of prices by colleges and universities remains the best solution.

23 Nickels, Lowell R. "Is a College Cap and Gown a Financial Ball and Chain?" Liber! Economic Information Newsletter (Research Library of the Federal Reserve Bank of St. Louis), August 2011.
24 Ibid.
Plan for declining governmental support

Mary F. Foster, Managing Director, Higher Education Practice, Grant Thornton LLP

Governmental support in the form of state appropriations, student financial aid, and grants and contracts has been declining for public universities and is likely to decrease for many private universities. Most state governments have been reducing their appropriations for public universities and have not increased tuition assistance programs for private universities.

Over the past decade, state governments in general have divested from higher education and shifted dollars to primary and secondary education. The divestiture by state governments is not just about competing priorities for state funding. It also signals the need for public universities to make their case to state governments for investing in high-quality, affordable college education that has solid student outcomes and proven economic benefits for the local municipality and for the state.

Although it has not declined for the past two years, federal funding for student financial aid is now under scrutiny by Congress and President Obama. The president's budget proposal to tie financial aid funding to tuition affordability is an extremely difficult issue for most private universities. The president's focus on job training and skills development programs, which would help the existing workforce remain employable and the unemployed find meaningful work, is not a core mission for the traditional four-year private college or university. If this shift in national focus is enacted in the upcoming budget, it will bring a reallocation of financial aid dollars from higher-priced four-year colleges to more moderately priced two-year colleges and technical schools. Even if this shift in funding priorities is temporary, its impact on four-year institutions, which require a consistent cohort of students during all four years, will be significant.

Federal funding for research has been bolstered in the past three years by American Recovery and Reinvestment Act (ARRA) funds and is not likely to grow in the foreseeable future. There is intense competition between the medical and nonmedical sciences for research dollars, and the allocation of appropriations among the National Institutes of Health, the National Science Foundation, and the Office of Naval Research will signal likely research priorities. For some universities, this will be good news; for others, the news will not be as hopeful.

Each university is left with determining what cuts in government aid to expect and which programs will feel the effects. Universities with well-established research projects and strong reputations will most likely not see a significant change in direct funding. However, universities that are seeking to garner a critical mass of research projects and grow their research programs may be at risk of funding cuts. But that also depends on the fields of research that faculty are pursuing and who their partners are. Collaborative research projects with other institutions are viewed as a competitive advantage, and they also spread the risk of funding variability among several institutions.

Against this backdrop of uncertain or declining governmental support, and in the face of a national outcry about rising tuition prices, universities must plan for the future. Part of this planning must entail resisting these trends and fighting for government funding. But pleas for more funding will not be persuasive if they are not supported with hard outcomes data. This data needs to dispel the notion that universities are inefficient, high-cost operations that are unresponsive to employers' demands, consumers' pocketbooks and students' needs. The case also needs to be made that endowment funds are designed to serve the university in perpetuity; they are not rainy-day funds as some would like to believe.

Perhaps the fundamental outcomes data is that which will help determine whether universities prepare students for a productive future that adds to the nation's economic growth and enables graduates to repay federal loans and live independently.
Of course, outcomes from private and public universities will be compared, and these comparisons are not without controversy.

Consider the first obvious issue: Is the tuition differential justified by the outcomes? While the top 10 percent of private universities may be able to justify tuition prices with differentiated outcomes, will the other 90 percent be able to do so? And what happens when public universities continue to raise tuition prices to offset cuts in state appropriations?

On the surface, the average policymaker or consumer believes these to be fair comparisons. However, the underlying dynamics of student readiness, university mission and values, and academic philosophy disturb these purportedly level comparisons between universities. Therefore, making the case for governmental support of higher education entails a reassessment of policymakers about the value of a degree — whether completed at a private university or a public one — along with a determination of whether the degree is affordable and can realistically be earned in four years or less. Unfortunately, affordability appears to mean parents' ability to pay based on tuition rates when they were in college. Tuition rates, even after discounts, are more than double those of 25 years ago, hence, the outcry against tuition prices and the level of debt that students have upon graduation.

If a private university is successfully graduating 90 percent of a cohort of students in four years and a public institution is doing so in six years, the higher tuition will likely be more than offset by the earnings power of the student during the additional two years. However, that scenario assumes a comparable level of student debt. If the parents' ability to pay is not at least 50 percent of the private tuition rate, then the student will have a higher proportion of debt to earnings. Compare tuition of $40,000 per year for four years to tuition of $17,000 to $20,000 per year for six years. The case for governmental support for private institutions may be even more difficult to justify if both private and public colleges are graduating 90 percent of their students in the same number of years. Then the price differential needs to be justified by net tuition paid and by the earnings differential and other student success factors.

The normal way to demonstrate value is through an assessment of on-time graduation rates, subsequent employment or entry into graduate programs in students' fields of study, career earnings that repay loans, research opportunities that enhance graduate applications, and certificate programs that help adult learners retool their skills while earning a degree. Other student success factors can include expedited job placement, internships, leadership roles that foster employment networks, paid graduate teaching or research activities, and entrepreneurial opportunities.
But those outcomes pertain only to the tuition pricing and financial aid components of governmental support. They may be persuasive to educators but not necessarily to funders. The biggest challenge is to demonstrate graduating a high percentage of freshmen in four years or less with debt loads that are commensurate with the earnings in their chosen profession. This will require a rethinking of net tuition prices for different majors, the provision of free or fee-based online courses that accelerate learning, the use of summer and winter sessions, and the pricing of tuition for unpaid internship semesters.

Research funding for those colleges and universities that are newer entrants into the world of laboratory research (wet research) will be harder to secure from the federal government and may be easier to obtain by garnering foundation and corporate support, and collaborating with larger institutions. Funding for written and published research (dry research) will not increase, and funders will be more attracted to collaborative studies. It would therefore behoove institutions to form a network of collaborative research partners and to identify emerging fields of research where the institution can be a subrecipient or subcontractor on various projects and the lead research institution on other projects. Mixing it up, so to speak, is also a good way to encourage newer faculty members to pursue wet and dry research projects. Research is important as a purely academic endeavor, but it takes on increased importance when it is one of the elements in demonstrating positive student outcomes.

Public universities face unique challenges with respect to state funding. During the past two decades, most states have either reduced the amount appropriated for public university operations or increased the appropriations at a level much lower than the increases in operating costs. Hence, at the end of 2011, state funding as a percentage of total university budgets was significantly less than it was 10 or 20 years ago. At the same time, some states have retained the authority to limit the tuition rate increases at their public universities, which represents a double revenue challenge for university administrators. For state officials, part of the policy debate over appropriations and tuition levels is about shifting the burden to parents to pay more for a public college education. Appropriations that support capital improvements for research facilities, along with technological and green infrastructure improvements, represent investments in the delivery of cost-effective education and real-time job creation. In other words, appropriations for these types of capital improvements help create jobs today and train people to succeed at jobs in the future.

Although the responses to the inevitable decline of governmental support are topics with which every administrator is familiar, the catalyst for making the case for governmental support of higher education — loudly, clearly and with demonstrable outcomes — should be the current federal and state budget crises we all face. It is easy to say the higher education model is broken when one has not really seen how the model works or measured the ultimate outcomes.
Fewer opportunities for revenue growth, growing criticism of current outcomes drive the need for paradigm shifts

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There are few universities that will see new revenue streams in the near future. Large research-based universities may experience spikes in technology transfer revenue, and institutions with sizable endowments are witnessing a rebound in their investment portfolios. But higher endowment earnings will be offset by lower spending rates — a lesson learned from the recent recession — so there will not really be new revenues for the operating budget. Furthermore, governmental support is generally on the decline; although that support is holding steady in some cases, increases in funding are not likely.

So the standard-bearers of university revenues are tuition and philanthropy. Large philanthropic gifts come with strings attached, and tuition increases come with public outcry and government threats. So for 2012 – 13, revenues will be driven by student volume, corporate and alumni giving, and competitive foundation and government grants. Of course, there is always the ability to look at facilities in a new light: Can revenues be generated by leasing out garage space, rooftops, classrooms, athletic facilities, labs and student housing?

But the critical paradigms that are shifting are about rethinking the delivery of education and making better use of existing assets and infrastructure. Hospitals and community colleges have been evolving to 24/7 operations so that more patients and students can be served in a high-quality and cost-effective manner. Businesses have been doing more with less this past decade. Four-year colleges and universities are seen by business executives and government as the last vestiges of a minimal workweek with luxury accommodations — in essence, costly and not accountable for the productivity of students or faculty. It doesn’t matter if that perception is fact-based or not — it drives public opinion and hence, policy decisions.

Let’s consider the recent building programs under way at many universities. The terms “adaptive reuse” and “redevelopment” need to be integrated into institutions’ vocabulary for describing capital and building programs. The best green initiative is not constructing a new building, but rather reusing and expanding what is there. The greenest development strategy is infill development, not building on greenfield lands. Those who pay the bills for education — government, business and parents — see new buildings on expanded campuses as expensive luxuries. Although new facilities may be needed, the scope and breadth of the building campaigns this past decade have been astonishing. And the prevailing belief is that these campaigns are driving up the cost of education at four times the rate of inflation.

This view may inform future building programs, but as of now there are new buildings on college campuses that can serve students in a more cost-effective manner. The challenge is to align facilities with curricula and the needs of 21st-century learners. First of all, not all learners will be traditional 18- to 24-year-old college students. Adult learners are a growing population that needs access to certificate programs, new degrees, specialized faculty advising and 24/7 online convenience. According to the Department of Education’s National Center for Education Statistics, the market for adult learners is the fastest-growing market for the foreseeable future. This market rose by 32.6 percent between 1995 and 2009 and is expected to rise by another 18.8 percent between 2009 and 2020.37 The recession accelerated this demand for adult education, with access and affordability being the critical factors. The adult learner needs flexibility, support structures and nontraditional hours. And the market for adult learners can cover the costs of new facilities.

Another leading perception is that higher education is not accountable for graduating highly skilled students on time. This criticism stems from the six-year graduation statistics that have become the norm, as well as the low levels of interpersonal and writing skills that graduates are seen to possess. The other elements in student success — or lack of success — that have come under attack are the poor quality of faculty advisement and the dearth of job readiness skills. These are areas where the use of social media, coaching, Skype and real-world interactions can merge. These are also areas that are ripe for interactions between the adult learner and the traditional learner. Expanding the opportunities for the traditional student to interact with the business-savvy adult learner will leverage the efforts of faculty advisers.

The challenge is to align facilities. Universities must be held accountable for the alignment of faculty and lab resources with the number of students requiring those courses. If new faculty line items or lab spaces cannot be added to the budget, then the use of what already exists must be expanded. With the correct use of technology, flexible spaces and in-classroom teaching, a class can serve 300 students as easily as 30 students.

The point is that colleges and universities, especially four-year institutions, need to respond to the perceived inadequacies of the educational system in order to stave off the criticisms of cost versus outcomes. Outcomes must improve or tuition revenue will be eroded by the lack of government and business support.

There is another critical paradigm that is shifting: accountability by school within a university for balancing its budget based on its own revenue. Though this may be fraught with political challenges, it drives front-line management accountability for course offerings, student retention and graduation rates, faculty advisement, and cost control. This approach also encourages alumni outreach and visible research, both of which are revenue generators.

Heightened accountability, increased pricing transparency and improved student outcomes are being demanded by the public. The higher education sector is more than capable of responding to these demands in an effective and innovative manner.
A new era in compensation

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The higher education community continues to seek out ways to respond to ongoing pressures being imposed upon leadership by regulators, donors, alumni, faculty and other stakeholders. The best protection against allegations of unreasonableness remains the implementation of sound governance practices in the compensation decision-making process.

Higher education compensation decision-making process

A clear and formal statement of purpose designating responsibility and authority is an essential element of the decision-making process for compensation committees. No matter who drafts the statement of purpose, the reality of why a committee has been formed, what responsibility it has in relation to the success of the institution, and what authority the committee and its members have to make and implement decisions and fulfill the institution’s purpose should be understood by board members and management alike.

Following is a sample statement of purpose for a compensation/human resources (HR) committee:

The compensation/HR committee (the committee) of Prestigious University (Prestigious) is a critical component of the overall governance role that the board of trustees has in relation to the ongoing leadership, decision-making and success of Prestigious. This committee will consist of five members of the board of trustees, each of whom is experienced in supporting complex, effective and compliant compensation, benefits, HR and/or succession planning programs in higher education or a similar environment. Each member receives a three-year appointment to the committee from the chairman of the board of trustees.

The committee is responsible for the oversight, administration and design of the various total compensation programs offered by Prestigious to its employee constituencies; serves as an adviser and partners with senior leadership in developing optimal HR strategies; oversees the administration of performance management programs; and evaluates, on at least an annual basis, the total compensation provided to the executive leadership team of Prestigious by comparing the institution’s total compensation offerings with those of similar institutions in a manner that is consistent with federal regulations. In addition, the committee is responsible for administering the performance evaluation process for the president of Prestigious and for establishing an effective succession planning program across the institution’s leadership.

The committee has the authority to hire advisers in relation to its responsibilities and is specifically charged with setting annual performance metrics for the president and the other members of the institution’s leadership team. Those positions may vary from year to year and time to time, but the leadership team will typically include the provost, the chief financial officer, the general counsel, the chief investment officer, the chief technology officer, the athletic director, the dean of the medical school, the dean of the law school and the dean of undergraduate studies. The committee will also have the authority to establish compensation levels, benefit offerings and employment conditions (e.g., terms of employment contracts, severance programs and deferred compensation arrangements) for the president and the other members of the leadership team on an annual basis, subject to the ability of the full board to be informed of any decisions that are made regarding the conditions of employment and/or tenure of the president of Prestigious.

The committee in its sole discretion may from time to time delegate its responsibilities to a subcommittee or special committee of the board, provided that authority for decision-making remains with the full committee. Examples of subcommittees are a president’s compensation committee, a physician compensation committee and a faculty compensation committee.
Incentive compensation and creating a pay-for-performance culture

Implementing a pay-for-performance culture remains challenging for many colleges and universities across the United States, yet the adoption of formal incentive compensation plans continues. As more institutions formalize the structure and operation of their compensation committees, the need for rigor in calibrating incentive compensation can present challenges. That said, following robust governance practices will lay a solid foundation for sound programs.

Below are some best practices:

- **Keep the business purpose rule in mind** — Effective compensation committees not only determine appropriate salaries and incentives, but also establish the link between total compensation and the institution’s mission and values.

- **Establish the rebuttable presumption of reasonableness** — The amounts and design of total compensation packages provided to a broad constituency of leadership individuals (e.g., disqualified persons, key employees) need to be reflected upon by appropriate decision-makers. Comparable external market data should be examined, and a formal process should be followed.

- **Consider the stakeholder optics** — Compensation decisions should take into account the effects that current or projected Form 990 disclosures, particularly those concerning salaries and incentives, are likely to have on stakeholders. The compensation committee and the board should be able to anticipate inquiries by preparing responses.

- **Maintain collaboration among leadership functions** — Through effective partnerships between their finance and HR departments, colleges and universities can deepen their understanding of how compensation and benefits programs can change the institution, help it deliver strong results, and facilitate operational success.
Governmental scrutiny through tax enforcement

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There is seemingly a new problem to tackle every day in the world of higher education — budget issues, tuition discounting, liquidity, opening a school, or perhaps starting a study-abroad program. Higher education institutions are facing all these issues and a plethora of others, including tax compliance matters. After all, colleges and universities have been granted tax-exempt status, and to maintain that status, they must comply with myriad rules and regulations at the federal, state, local and international levels.

In the federal tax compliance arena, the most common issues involve unrelated business income (UBI). This is especially important because UBI audits are a revenue generator for the federal government. The IRS has UBI examinations under way that stem from its recently completed Colleges and Universities Compliance Project. That study revealed that many respondents conducted UBI-producing activities but did not report them as such. In addition, most of those that reported UBI had net losses from these activities. As a result, the IRS has sharpened its focus on UBI-producing activities, checking into whether institutions are reporting their UBI appropriately and whether the expense allocations made for those activities truly bear a direct and causal relationship to them. Further, the IRS is taking the position that when activities result in losses in three out of five years, institutions cannot use those losses to offset gains produced by other UBI activities. Because of this sharpened focus, we have seen many institutions undergo a review of their UBI activities in preparation for a potential IRS examination. We expect this trend to continue throughout 2012.

The IRS has also sharpened its focus on employment taxes. Employment tax examinations can be performed by the Exempt Organizations Unit or the Employment Tax Unit, which have similar objectives. Areas of concentration include excessive compensation, especially as it relates to executives (i.e., intermediate sanctions), the taxation of benefits, including perquisites provided to key employees, and worker classification.

Form 990 is a major source of information for the IRS in selecting institutions for examination. What is disclosed on that return, especially in the compensation section, can greatly increase an institution’s chance of being audited. Does your institution pay for companion travel (which the IRS very strongly feels is taxable)? Do you provide personal services such as maid service for the president? Do you pay for golf or country club dues? All of these perks should be considered taxable compensation unless they have a clearly defined business purpose that can be supported and documented.

In the worker classification arena, the IRS follows established guidelines in determining who has control of the workers’ duties and the relationships that exist between the institution and the workers (including the longevity of those relationships). Often it is the failure to document these relationships that results in adverse determinations by the IRS. Do you have contracts in place that clearly set forth the job specifications and the financial aspects and terms of each relationship? Can the institution document that the workers hold themselves out to others to provide similar services? These are some ways to bolster your position when treating an individual as an independent contractor. In looking at worker classification, the IRS chooses a test sample and then extrapolates the results across an institution’s entire population. Because of this sampling technique, adverse findings in the tested sample cause taxes and penalties to add up quickly. Many institutions have revised their employment tax practices to mitigate their risk. We recommend taking such action.

Foreign tax compliance is still another area of sharpened IRS focus. There has been much to-do over Foreign Bank and Financial Accounts filings over the past two years, but what has